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August 5, 2016

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Robert Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW, Washington,
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By Electronic Submission

Re: Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements (the “NSFR Rule”)¹

The American Council of Life Insurers (ACLI) is a national trade association with 280 member companies that represent 95 percent of industry assets, 92 percent of life insurance premiums, and 97 percent of annuity considerations in the United States. Our members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance that 75 million American families rely on for financial and retirement security.

Life Insurers have actively participated in the dialogue concerning the regulation of domestic and international derivatives markets, and have provided constructive input on proposed rulemaking implementing Title VII and Section 619 of the Dodd Frank Wall Street Reform and Consumer Protection Act (the “Dodd Frank Act”).²

¹ The proposed NSFR Rule appears at 81 Fed. Reg. 35124 (June 1, 2016) [<https://www.gpo.gov/fdsys/pkg/FR-2016-06-01/pdf/2016-11505.pdf>].

² For example, ACLI submitted detailed comments on the following parallel regulatory proposals developed by the U.S. Prudential Regulators, the U.S. Commodity Futures Trading Commission (“CFTC”), and the U.S. Securities and Exchange Commission (“SEC”):

- Supplemental Request for Comments on Proposed Margin and Capital Requirements for Covered Swap Entities;

We greatly appreciate the opportunity to offer our commentary on the NSFR Rule currently proposed by the Board of Governors of the Federal Reserve System, the Comptroller of the Currency and the Federal Deposit Insurance Company (the “Regulatory Agencies”). The ACLI supports the underlying principle of the NSFR Rule, that Financial Institutions should “maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities”³. However, we reiterate our concerns addressed in our comment letter dated July 12, 2015 attached hereto as Appendix A that certain aspects of the NSFR are inconsistent with other components of the global financial market reform efforts and will significantly impede the ability of Financial End-Users such as Life Insurers, Pension Plans, and other Asset Managers, to prudently and cost effectively manage their investment portfolios. Ultimately, the increased costs associated with Life Insurers’ hedging activity may impact the pricing of products and consumers. We strongly urge the Regulatory Agencies to reconsider these points set forth in the referenced comment letter when drafting the final NSFR Rule for the U.S. financial markets and we have summarized our position on these issues below.

Summary of ACLI’s Positions

The proposed NSFR Rule would require banks to maintain a Required Stable Funding (“RSF”) weighting on its assets which is offset by an Available Stable Funding (“ASF”) weighting on its funding liabilities; resulting in a profile that limits the maturity mismatch risk between a bank’s assets and funding liabilities. We continue to believe that, in application, the NSFR Rule will have a chilling effect on the overall ability of banks to execute its primary function of providing financial intermediation in the US economy. And while we recognize that the goal of the Regulatory Agencies is to ensure the safety and soundness of the US banking system, we believe that the ancillary effect of the NSFR Rule creates a disincentive for insurers and other financial end-users to

[http://www.fhfa.gov/webfiles/24691/95_American%20Council%20of%20Life%20Insurers%20ACLI.pdf] [Prudential Regulators];

- Supplemental Request for Comments on Proposed Margin Requirements Governing Uncleared Swap Transactions for Swap Dealers and Major Swap Participants

[<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58806&SearchText=wilkerson>] [CFTC];

- CFTC Proposal on Protection of Cleared Swaps Customer Contracts and Collateral [<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48045&SearchText=wilkerson>] [CFTC];

- SEC proposal on margin, capital and segregation for security-based swap dealers and major security-based swap participants [<http://www.sec.gov/comments/s7-08-12/s70812-25.pdf>]; and,

- Request for Comments on Reproposed Rule for Margin and Capital Requirements for Covered Swap Entities [http://www.federalreserve.gov/SECRS/2015/January/20150127/R-1415/R-1415_112414_129786_278794149594_1.pdf].

ACLI also submitted comments on the initial BCBS-IOSCO Consultative Document for Non-Centrally Cleared Derivatives, published by the Basel Committee on Bank Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) (May 2012) (“BCBS-IOSCO Consultative Paper”)

[<http://www.bis.org/publ/bcbs226/acoli.pdf>] [BCBS-IOSCO], and the BCBS-IOSCO Second Consultative Document on Margin Requirements for Non-Centrally Cleared Derivatives (Feb. 2013) (“Second BCBS-IOSCO Consultative Paper”) [<http://www.bis.org/publ/bcbs242.pdf>].

³ See Basel Committee on Banking Supervision, Basel III: the Net Stable Funding Ratio (Oct. 2014) at <http://www.bis.org/bcbs/publ/d295.pdf>.

manage their own asset and liability risks through the deployment of short term cash investments and the use of derivatives for hedging long term risks. We urge the Regulatory Agencies to balance the primary objective of this rule against the negative externalities affecting the broader financial markets and end-user participants when considering our specific objections set forth below.

I. Securities held for market-making activity have shorter-term funding requirements than those held for investment purposes.

Securities held by a bank for market-making purposes will carry the same RSF requirement as those held for long-term investment. Given the strict requirements of 17 CFR Part 255 (“the Volcker Rule”)⁴ for market making activity, we believe that this treatment is unnecessarily punitive.⁵ We request that the Regulatory Agencies consider the current impact of the Volcker Rule on market making activities before implementing an RSF weighting on these activities that may accelerate the declining liquidity that currently exists within the fixed-income markets.

II. Tenor guidelines for determining available stable funding are arbitrary and may create unintended consequences.

The tenor guidelines within the ASF weighting mechanism are arbitrary and do not provide any weighting factor for secured stable funding that carries a maturity of less than 6 months. Failure to provide any weighting percentage for short term financing within the ASF may create unintended structural changes in the broader secured funding markets. We believe that the NSFR must reflect a consistency among co-existent regulatory requirements and alternatives within the broader financial markets, and that a graduated ASF calculation, utilizing the effective residual maturity of all transactions with maturities from 1 month to one year, would significantly mitigate the potential structural dislocation in the short term funding markets as well as the loss of secured funding transactions between insurance companies and banks. By way of example, the following table outlines a proposed approach:

Months	ASF Percentage
1	10%
2	18%
3	26%
4	34%
5	42%
6	50%
7	58%
8	67%
9	75%
10	83%
11	92%
12	100%

⁴ See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds; Final Rule, 17 CFR Part 255, available at <http://www.gpo.gov/fdsys/pkg/FR-2014-01-31/pdf/2013-31511.pdf>

⁵ Our position is explained further in our comments on the Secondary Impact of the Volcker Rule on Market Making (Feb. 13, 2012) which appears at http://www.federalreserve.gov/SECRS/2012/March/20120301/R-1432/R-1432_021312_105466_511629546996_1.pdf

III. Non-Cash Collateral for Variation Margin should be afforded a stable funding benefit greater than zero.

The NSFR Rule employs a rigid approach regarding the type of ASF that is available to offset the RSF of derivative assets held by banks. Under the current framework, only cash qualifies as an ASF offset to Derivative Assets, while non-cash collateral posted by Derivative End-Users currently receives a 0% ASF weighting in the NSFR. The NSFR negates the intent of, and benefit obtained from, the inclusion of eligible non-cash collateral as set forth in the Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (the “Margin Rules”)⁶. We believe that this component of the NSFR would substantially change the economics of OTC Derivatives trades, particularly those entered into by Life Insurers who have historically relied on a wide range of high quality securities that are eligible for posting as derivatives margin. In order to maintain consistency with the Margin Rules and BCBS-IOSCO international guidelines for acceptable classes of Derivatives collateral types⁷, non-cash collateral should be afforded an ASF weighting greater than zero. Accordingly, we urge the Regulatory Agencies to expand the range of assets that would provide an ASF offset for derivative assets held by banks to include non-cash collateral. By way of example, we would suggest an ASF weighting for High Quality Liquid Assets (“HQLA”) similar to the haircuts used by the Fed for HQLA collateral accepted at the Discount Window.⁸

Discount Window and Payment System Risk Collateral Margins Table

Securities	Margins for Securities (% of market value or internal fair market value estimate) ³		
	Duration Buckets		
	0-5	>5-10	>10
U.S. Treasuries & Fully Guaranteed Agencies			
Bills, Notes, Bonds, Floating Rate Notes, and Inflation-Indexed	99%	97%	95%
Zero Coupon, STRIPS	98%	96%	92%
Government Sponsored Enterprises			
Bills, Notes, and Bonds	98%	96%	94%
Zero Coupons	97%	95%	91%
Foreign Government, Foreign Government Guaranteed, and Brady Bonds			
AAA rated - U.S. Dollar Denominated	98%	96%	94%
BBB-AA rated - U.S. Dollar Denominated	97%	95%	92%
Foreign Government Agencies			

⁶ Final Rule, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 6, 2016) [<https://www.gpo.gov/fdsys/pkg/FR-2016-01-06/pdf/2015-32320.pdf>].

⁷ These include Cash, High-quality government and central bank securities, High-quality corporate bonds, High-quality covered bonds, Equities included in major stock indices, and gold.

⁸ See <https://www.frbdiscountwindow.org/Pages/Collateral/Discount-Window%20and%20Payment-System-Risk-Collateral-Margins-Table.aspx>

Securities	Margins for Securities (% of market value or internal fair market value estimate) ⁹		
	Duration Buckets		
	0-5	>5-10	>10
BBB-AAA U.S. Dollar Denominated	98%	96%	91%
Supranationals			
Bills, Notes, and Bonds - U.S. Dollar Denominated	98%	96%	94%
Zero Coupons - U.S. Dollar Denominated	97%	95%	91%
Corporate Bonds			
AAA rated - U.S. Dollar Denominated	98%	95%	93%
BBB-AA rated - U.S. Dollar Denominated	96%	94%	92%

IV. Valuation disputes should not give rise to a stable funding need on the entire collateral balance.

Temporary derivative valuation disputes occur between counterparties due to differences in pricing models, or underlying market data. Such valuation disputes are typically small relative to the overall derivative asset/liability, and are normally resolved within a reasonable period of time. However, the NSFR cross reference to the BCBS Consultative Document Revisions to the Basel III leverage Ratio Framework (the “Leverage Ratio Framework”) would preclude **all** variation margin received as being eligible ASF to offset a derivative asset⁹ during the pendency of such dispute. In the event of a derivatives valuation dispute between parties, a bank’s RSF weighting requirement should be limited solely to the amount in dispute, and should not eliminate the stable funding benefit of the entire amount of variation margin (VM) posted. The current BCBS Consultative Document Revisions to the Basel III leverage Ratio Framework has remedied this condition by providing that; *“In situations where the intent to extinguish the mark-to-market exposure (subject to thresholds and minimum transfer amounts) but a margin dispute arises, any non-disputed margin that has been exchanged can be recognized.”* We agree with the BCBS position on this issue and urge the Regulatory Agencies to adopt the same in the final NSFR Rule.

⁹ In the event of a valuation dispute, variation margin that fails to meet the full amount required is disallowed under the LCR. This would cause a bank to raise High Quality Liquid Assets (HQLA) within the LCR framework. This may be an appropriate response as the higher liquidity buffer would protect a bank against a potentially growing valuation dispute. Raising long term funding for the entire variation margin balance in response to such an event (as would be implicitly required under the NSFR), is not appropriate, since the incremental funding need is limited to the amount of the valuation dispute.

Conclusion

Minimizing the maturity mismatch between assets and funding liabilities forms a key part of the overall risk management strategy for financial institutions. Life insurers fully appreciate the policy objectives of integrating the NSFR into the regulatory framework for banks. However, we believe that by incorporating our proposed modifications, those objectives can continue to be achieved without unduly impacting financial end users.

Thank you for your attention to our views. If any questions develop, please let me know.

Sincerely,

Carl B. Wilkerson

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July 12, 2015

Re: BCBS Basel III: the Net Stable Funding Ratio¹ (the “NSFR”)

The American Council of Life Insurers (“ACLI”) is a national trade association with 300 members that represent more than 90 percent of the assets and premiums of the life insurance and annuity industry in the United States. Many of our members also provide life insurance, annuity and employee benefit programs on a global basis. We greatly appreciate the opportunity to offer the Regulatory Agencies our commentary on the Net Stable Funding Ratio finalized by the Basel Committee on Banking Supervision as part of Basel III, as we understand that the Regulatory Agencies are considering a similar proposal for entities under their jurisdiction.

Life Insurers have actively participated in the dialogue concerning the regulation of domestic and international derivatives markets, and have provided constructive input on proposed rulemaking implementing Title VII and Section 619 of the Dodd Frank Wall Street Reform and Consumer Protection Act (the “Dodd Frank Act”)². The ACLI supports the underlying principle of the NSFR,

¹ See Basel Committee on Banking Supervision, Basel III: the net stable funding ratio, October 2014, available at <http://www.bis.org/bcbs/publ/d295.pdf>

² ACLI submitted detailed comments on the following parallel regulatory proposals developed by the Prudential Regulators, the U.S. Commodity Futures Trading Commission (“CFTC”), and the U.S. Securities and Exchange Commission (“SEC”):

- Supplemental Request for Comments on Proposed Margin and Capital Requirements for Covered Swap Entities;

that Financial Institutions should “maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities”³. However, we believe that certain aspects of the BCBS Final Rule are inconsistent with other closely related components of the global financial market reform efforts and, further, have the potential to significantly raise the costs of managing investment portfolios for Financial End-Users such as Life Insurers, Pension Plans, and other Asset Managers. We therefore urge the Regulatory Agencies to consider these points in drafting rules for the U.S. financial markets.

Summary of ACLI’s Positions

The NSFR attempts to create a regulatory regime that requires banks to maintain a stable funding profile by applying a Required Stable Funding (“RSF”) weighting on its assets which is then offset by an Available Stable Funding (“ASF”) weighing to its funding liabilities; the goal of which is an ASF weighting that is greater than or equal to the RSF weighting. Since each of the ASF and RSF weightings are a function of the liquidity characteristics, counterparty, and residual maturities of the assets and funding liabilities of the institution, the NSFR seeks to limit the maturity mismatch risk between a bank’s assets and funding liabilities. However, we have concerns that the Rule, when applied, may have a chilling effect on the overall ability of banks to support financial intermediation. Further, we believe that the application of certain components of these rules is punitive and creates a disincentive for insurers and other financial end-users to manage their own asset and liability risks through the deployment of cash in investments under one year in maturity and in the use of derivatives for hedging long term risks. Specifically, we object to the components of the NSFR set forth below. We respectfully request that the Regulatory Agencies consider these provisions with a view toward the ancillary effects of these components on the broader financial markets and their participants.

[http://www.fhfa.gov/webfiles/24691/95_American%20Council%20of%20Life%20Insurers%20ACLI.pdf]
[Prudential Regulators];

- Supplemental Request for Comments on Proposed Margin Requirements Governing Uncleared Swap Transactions for Swap Dealers and Major Swap Participants [<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58806&SearchText=wilkerson>] [CFTC];
- CFTC Proposal on Protection of Cleared Swaps Customer Contracts and Collateral [<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48045&SearchText=wilkerson>] [CFTC];
- SEC proposal on margin, capital and segregation for security-based swap dealers and major security-based swap participants [<http://www.sec.gov/comments/s7-08-12/s70812-25.pdf>]; and,
- Request for Comments on Reproposed Rule for Margin and Capital Requirements for Covered Swap Entities [http://www.federalreserve.gov/SECRS/2015/January/20150127/R-1415/R-1415_112414_129786_278794149594_1.pdf].

ACLI also submitted comments on the initial BCBS-IOSCO Consultative Document for Non-Centrally Cleared Derivatives, published by the Basel Committee on Bank Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) (May 2012) (“BCBS-IOSCO Consultative Paper”) [<http://www.bis.org/publ/bcbs226/acoli.pdf>] [BCBS-IOSCO], and the BCBS-IOSCO Second Consultative Document on Margin Requirements for Non-Centrally Cleared Derivatives (Feb. 2013) (“Second BCBS-IOSCO Consultative Paper”) [<http://www.bis.org/publ/bcbs242.pdf>].

³ NSFR at 1

- Securities held by a bank for market-making purposes will carry the same RSF requirement as those held for long-term investment. Given the strict requirements of 17 CFR Part 255 (“the Volcker Rule”)⁴ for market making activity, we believe that this treatment is unnecessarily punitive, and will accelerate the condition of declining liquidity that exists within the fixed-income markets currently.
 - The tenor guidelines within the ASF weighting mechanism are arbitrary and do not provide any weighting factor for stable funding sourced from financial institutions that carry a maturity of less than 6 months. Failure to provide any weighting percentage for short term financing within the ASF may create unintended structural changes in the broader secured funding markets.
 - Non-cash collateral posted by Derivative End-Users currently receives a 0% ASF weighting in the NSFR. In order to maintain consistency with BCBS-IOSCO international guidelines for acceptable classes of Derivatives collateral types, non-cash collateral should be afforded an ASF weighting greater than zero.
 - Initial margin posted by Derivative End-Users currently receives a 0% ASF weighting and does not offset Derivative Assets. With limited rehypothecation rights, initial margin received from Derivative End-Users should be afforded an ASF weighting greater than zero in order to offset the Required Stable Funding (RSF) of initial margin posted by banks.
 - In the event of a derivatives valuation dispute between parties, a bank’s RSF weighting requirement should be limited solely to the amount in dispute. A valuation dispute with a Derivative End-User should not eliminate the stable funding benefit of the entire amount of variation margin (VM) posted.
- I. Securities held for market-making activity have shorter-term funding requirements than those held for investment purposes.**

When allocating RSF weightings, the NSFR makes no distinction between securities held as part of a bank’s market making activities and those securities held in respect of a bank’s investment activity. Securities held for market making have shorter-term funding requirements and should carry a lower RSF weighting than investment securities. We also urge you to consider the interaction between the NSFR requirements and the robust requirements of the Volcker Rule governing market-making activity within the United States. We believe that an additional NSFR requirement for this activity is unnecessarily punitive. Declining liquidity in the fixed-income markets is a real and growing concern among market participants. We believe that the NSFR may have a further detrimental effect on activity that has already been defined under the Volcker Rule as short-term in nature.

The Volcker Rule prescribes strict limits on activity defined as market-making. It includes a requirement that a Trading Desk routinely stand ready to purchase and sell financial instruments, and be willing and able to quote, purchase, and sell those instruments in commercially reasonable

⁴ See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds; Final Rule, 17 CFR Part 255, available at <http://www.gpo.gov/fdsys/pkg/FR-2014-01-31/pdf/2013-31511.pdf>

amounts throughout market cycles⁵. The Volcker Rule also contains reporting requirements regarding market making activity, including inventory aging, inventory turnover, and other statistics⁶. The new Volcker Rule requirements will preclude banks from carrying large inventories of illiquid securities for indeterminable holding periods within their market-making operations. Securities held for market-making are expected to be held for a short period of time. In contrast, securities held in a bank's investment portfolio are typically purchased with the intent to hold them for a much longer holding period. Accordingly, we request that the Regulatory Agencies consider the current impact of the Volcker Rule on market making activities before implementing an RSF weighting on these activities that may accelerate the declining liquidity that exists within the fixed-income markets currently.

II. Tenor guidelines for determining available stable funding are arbitrary and may create unintended consequences.

The NSFR determines the weighting for available stable funding (including secured funding through repurchase agreements) based upon the tenor of such funding. Secured funding from financial institutions (including Insurance Companies) receive ASF weightings based on the following schedule⁷:

Tenor	ASF Factor
Effective Residual Maturity >= 1 year	100%
Effective Residual Maturity >= 6 months and < 1 year	50%
Effective Residual Maturity < 6 months	0%

This current schedule provides no weighting at all for secured funding from financial institutions with maturities less than 6 months, and is likely to negatively impact both the ability of banks to fund on a short term basis and provide credit on a long term basis. Banks have traditionally been an intermediary in liquidity / maturity transformation and this component of the NSFR is likely to cause a structural change in the financial markets (in particular the Repo and securities lending markets) with consequences that affect the stability of financial markets. Further, this component will likely limit short term investment opportunities for market participants, including insurers. Generally, insurers are *prohibited* from engaging in repurchase agreements that have a maturity greater than one-year. The National Association of Insurance Commissioners (NAIC) Investments of Insurers

⁵ Each of the Volcker Rule regulations are codified in different sections of the Code Federal Regulations (C.F.R.) (12 C.F.R. Part 44 [Office of the Comptroller of the Currency (OCC)]; 12 C.F.R. Part 248 (Board of Governors of the Federal Reserve System (FRB)); 12 C.F.R. Part 351 (Federal Deposit Insurance Corporation (FDIC)); 17 C.F.R. Part 255 (Securities and Exchange Commission (SEC)); and 15 C.F.R. Part 75 (CFTC)). Hereinafter, all citations to the regulations will leave references to the CFR title and section blank because they vary from regulator to regulator, and instead will be distinguished by subsections, which generally are consistent among all of the federal financial regulators (e.g., __ C.F.R. §__.1). __ C.F.R. §__.4(a)(2) of each of the respective regulations governs market making activities and responsibilities of the trading desk.

⁶ __ C.F.R. §__.2 sets forth the reporting requirements for market making activities.

⁷ NSFR at 21 and 24

Model Act⁸, which serves as the template for uniform laws governing the investment activities of Life Insurers, stipulates a one-year maximum tenor for these transactions. Insurance Companies deploy short-term cash into Repurchase arrangements as part of their overall asset-liability and liquidity management strategies. We believe that the conflict between the tenor restrictions imposed by the NAIC and the arbitrary ASF Factors described in the schedule have the potential to create the unintended consequence of unnecessarily limiting investment alternatives for Insurance Companies and potential sources of valuable term funding for banks.

We believe that the NSFR must reflect a consistency among co-existent regulatory requirements and alternatives within the broader financial markets. Further, we believe that a graduated ASF calculation, utilizing the effective residual maturity of all transactions with maturities from 1 month to one year, would significantly mitigate the potential structural dislocation in the short term funding markets as well as the loss of secured funding transactions between insurance companies and banks. By way of example, the following table outlines a proposed approach:

Months	ASF Percentage
1	10%
2	18%
3	26%
4	34%
5	42%
6	50%
7	58%
8	67%
9	75%
10	83%
11	92%
12	100%

This modification would serve to maximize the amount of stable funding available to banks, while maintaining the core objectives of the NSFR.

III. Non-Cash Collateral for Variation Margin should be afforded a stable funding benefit greater than zero.

The NSFR employs a rigid approach regarding the type of ASF that is available to offset the RSF of derivative assets held by banks. Under the current framework, only cash qualifies as an ASF offset to Derivative Assets (emphasis added):

“... In calculating NSFR derivative assets, collateral received in connection with derivative contracts may not offset the positive replacement cost amount, regardless

⁸ See National Association of Insurance Commissioners, Investments of Insurers Model Act (Defined Limits Version), October 1996, Section 16 (B), available at <http://www.naic.org/store/free/MDL-280.pdf>

*of whether or not netting is permitted under the bank's operative accounting or risk-based framework, **unless it is received in the form of cash variation margin...***⁹

We believe that the NSFR is inconsistent with the BCBS-IOSCO Margin Requirements for Non-Centrally Cleared Derivatives¹⁰ (the "Margin Requirements"), and overlooks the broader implications of market liquidity that occur when non-cash collateral is permitted to be posted in respect of OTC derivatives transactions. Within the Margin Requirements, BCBS-IOSCO noted the inherent trade-off between strictly limiting eligible collateral to cash, versus the flexibility of allowing a broad range of collateral types to be used for margin¹¹. They noted that their final rule on Margin Requirements (the "Final Rule") incorporated alternative collateral types as eligible, and conducted their Quantitative Impact Study (the "QIS") on this basis¹². By providing no ASF offset for non-cash collateral posted to banks, the NSFR does not differentiate between end-users who pledge non-cash collateral, and end-users who are completely uncollateralized. The NSFR negates the Margin Rules' inclusion of non-cash collateral in the list of eligible collateral. In our comments to the Prudential Regulators and the CFTC on their proposed rules for margin for uncleared swaps¹³, we emphasized our agreement with the Margin Requirements on the inclusion of non-cash collateral as eligible collateral. Traditionally, life insurers have posted high quality non-cash collateral as variation margin in respect of uncleared swaps and a requirement of cash-only variation margin would require life insurers to partially liquidate higher yielding assets to meet cash VM requirements. For the same reasons we argued for a wide range of collateral to be considered eligible collateral for transfers of variation margin, we urge the Regulatory Agencies to expand the range of assets that would provide an ASF offset for derivative assets held by banks.

It is noteworthy that the Final Rule would only apply to transactions entered into after an applicable phase-in date. In contrast, the NSFR would apply to all derivative trades that a bank has entered into; notwithstanding the date such transactions were executed.¹⁴ We believe that this component

⁹ NSFR at 35

¹⁰ See Basel Committee on Banking Supervision & Board of the International Organization of Securities Commissions ("BCBS-IOSCO"), Margin Requirements for non-centrally cleared derivatives, March 2015, available at <http://www.bis.org/bcbs/publ/d317.pdf>

¹¹ BCBS-IOSCO included examples of the types of collateral that were consistent with their key principle. These included Cash, High-quality government and central bank securities, High-quality corporate bonds, High-quality covered bonds, Equities included in major stock indices, and gold.

¹² The Margin Requirements noted the importance of liquidity concerns in the formation of that Rule. "*The overall liquidity burden resulting from initial margin requirements, as well as the availability of eligible collateral to satisfy such requirements, has been carefully assessed in designing the margin framework. The use of permitted initial margin thresholds, which are discussed in detail in Element 2, the eligibility of a broad range of eligible collateral, which is discussed in detail in Element 4, the ability to re-hypothecate some initial margin collateral under strict conditions, which is discussed in Element 5, as well as the triggers that provide for a gradual phase-in of the requirements, which are discussed in detail in Element 8, have been included as key elements of the margin framework to directly address the liquidity demands associated with the requirements.*" (Margin Requirements at pg 4-5)

¹³ See Request for Comments on Reproposed Rule for Margin and Capital Requirements for Covered Swap Entities [http://www.federalreserve.gov/SECRS/2015/January/20150127/R-1415/R-1415_112414_129786_278794149594_1.pdf] at pg 5-7

¹⁴ Under the Reproposed Rules, market participants will have a choice whether to net legacy trades with new trades done under the new margin regime, or to maintain legacy trades under their existing documentation in a separate netting set. It is our expectation that many Financial End-Users will choose the latter option in many instances. Unlike the Reproposed Rule, the NSFR would impact all derivatives currently held by a

of the NSFR would substantially change the economics of existing OTC Derivatives trades, particularly those entered into by Life Insurers who have historically relied on a wide range of securities that were eligible for posting as derivatives margin.

Potential illiquidity and pricing concerns for non-cash collateral have traditionally been addressed through the use of prudent haircuts, daily exchange of collateral, and low minimum threshold amounts. These market practices provide significant protections to derivative end-users, and to banks who accept and post non-cash collateral. The result of the NSFR would be to substantially penalize end users who merely retain the right to post securities as derivatives collateral under their pre-existing collateral agreements.

IV. Initial margin received from Derivative End-Users should receive a funding benefit.

Initial Margin is treated asymmetrically within the NSFR¹⁵. Initial Margin received by a bank receives a 0% ASF weighting, while initial margin posted by a bank receives an 85% RSF weighting. In the case where initial margin was subject to full segregation, this treatment may be appropriate, as it would create a substantial funding requirement and significantly increase the liquidity impact of bilateral 2-way initial margin posting between a bank and its derivative counterparties. However, rehypothecation of initial margin is a common and continuing market practice for uncleared OTC derivatives and serves to reduce the funding requirements engendered by that full collateral segregation.¹⁶

The tradeoff between market liquidity and the protection afforded by the gross exchange of initial margin was specifically recognized by BCBS-IOSCO in the Margin Requirements and by the U.S. Prudential Regulators in Margin and Capital Requirements for Covered Swap Entities: “Reproposed Rule” [RIN 2590-AD43]¹⁷. The Margin Requirements specifically allow for a one-time rehypothecation, re-pledge, or re-use of initial margin collected from a customer under certain circumstances¹⁸. The Prudential Regulators sought comment on this aspect of the Margin Requirements in their Reproposed Rule:

“The 2013 international framework sets out parameters for member countries to permit a limited degree of rehypothecation, replying, and reuse of initial margin collateral when a covered swap entity is dealing with a financial end user if certain

bank, and would impose significant potential costs on those that can use non-cash collateral to fulfill margin requirements. Thus, the NSFR will have the effect of altering the economics of trades done prior to enactment.

¹⁵ Initial Margin received is discussed in NSFR at 35 (b) as a part of ASF. Initial Margin posted is discussed in NSFR at 42 (a) as a part of RSF.

¹⁶ According to the 2014 ISDA Margin Survey, 85% of Government Securities and 55% of other securities pledged globally at the end of 2013 were eligible for rehypothecation. While the percentage of securities actually rehypothecated was lower at 45% and 30%, respectively, rehypothecation is still an important tool that derivative users can employ to reduce the funding requirements of collateralization. It is important to note that the 2014 ISDA survey was conducted during a period of market stability. In a changing market environment, one would expect OTC derivative users to make increasing use of rehypothecation. (See International Swaps and Derivatives Association, ISDA Margin Survey 2014, April 2014, available at <http://www2.isda.org/attachment/Njc3NQ==/2014%20ISDA%20Margin%20Survey.pdf>)

¹⁷ 79 Fed. Reg. Vol 79, No. 185 (Sept 24, 2014), 57348 at page 57374.

¹⁸ Margin Requirements at 5(iv) and 5(v).

safeguards for protecting the financial end user's rights in such collateral are available under applicable law. If such protections exist, under the 2013 international framework, a member country may allow a swap entity to rehypothecate, repledge, or reuse initial margin provided by a non-dealer financial end user one time to hedge the covered swap entities exposure to the financial end user. The Agencies seek comment on the circumstances under which one-time rehypothecation, repledge, or reuse of initial margin posted by a non-dealer financial end user would be permitted under the 2013 international framework and whether this would be a commercially viable option for market participants.”¹⁹

For the sake of consistency, any initial margin posted to a bank, and which carries the right for a one-time re-hypothecation, should be afforded an appropriate ASF weighting to offset any initial margin amounts posted with an RSF weighting. We respectfully urge the Prudential Regulators to take this condition into consideration when both finalizing their Reproposed Rule, and in creating a U.S. proposed rule for the NSFR.

V. Valuation disputes should not give rise to a stable funding need on the entire collateral balance.

Derivative valuation disputes may temporarily arise between counterparties for various reasons, including differences in pricing models, or underlying market data. These differences are typically small as a percentage of the overall derivative asset/liability, and are normally resolved within a reasonable period of time. During the pendency of this dispute one party may have uncollateralized exposure to the other party in respect of the disputed amount.

The NSFR allows variation margin received to offset a derivative asset provided such variation margin is in the form of cash, and further meets the conditions specified in paragraph 25 of the Basel III leverage ratio framework and disclosure requirements²⁰ (the “LCR”). The LCR defines eligible variation margin, in part, as:

“... Variation margin exchanged is the full amount that would be necessary to fully extinguish the mark-to-market exposure of the derivative subject to the threshold and minimum transfer amounts applicable to the counterparty.”²¹

In the event of even a relatively minor valuation dispute, the NSFR would preclude **all** VM received as being eligible ASF to offset a derivative asset²². Thus, a sudden need for stable funding could arise in the case of a comparatively small valuation dispute. We believe that any RSF requirement

¹⁹ Reproposed Rule at page 57374.

²⁰ See Basel Committee on Banking Supervision, Basel III leverage ratio framework and disclosure requirements, January 2014, available at <http://www.bis.org/publ/bcbs270.pdf>

²¹ LCR at 25. (iv)

²² In the event of a valuation dispute, variation margin that fails to meet the full amount required is disallowed under the LCR. This would cause a bank to raise High Quality Liquid Assets (HQLA) within the LCR framework. This may be an appropriate response as the higher liquidity buffer would protect a bank against a potentially growing valuation dispute. Raising long term funding for the entire variation margin balance in response to such an event (as would be implicitly required under the NSFR), is not appropriate, since the incremental funding need is limited to the amount of the valuation dispute.

in connection with derivatives valuation disputes should be limited solely to the disputed amount. VM posted to satisfy the undisputed amount should continue to qualify as ASF under the NSFR.

Conclusion:

Minimizing the maturity mismatch between assets and funding liabilities forms a key part of the overall risk management strategy for financial institutions. Life insurers fully appreciate the policy objectives of integrating the NSFR into the regulatory framework for banks. However, we believe that by incorporating our proposed modifications, those objectives can continue to be achieved without unduly impacting financial end users.

We greatly appreciate your attention to our views. Please let me know if you have any questions.

Sincerely,

/S/

Carl B. Wilkerson

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